

**BLACK HILLS EDUCATIONAL  
BENEFITS COOPERATIVE**

**FINANCIAL STATEMENTS**

**JUNE 30, 2008 AND 2007**



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
JUNE 30, 2008 AND 2007**

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Black Hills Educational Benefits Cooperative  
Sturgis, South Dakota

We have audited the accompanying financial statements of Black Hills Educational Benefits Cooperative (the Cooperative) (a public entity risk pool) as of and for the years ended June 30, 2008 and 2007 which collectively comprise the Cooperative's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designating audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control over financial reporting. Accordingly, we do not express such an opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Black Hills Educational Benefits Cooperative as of June 30, 2008 and 2007, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



## INDEPENDENT AUDITOR'S REPORT (CONTINUED)

The Cooperative has not presented certain revenue and claims development information that accounting principles generally accepted in the United States of America has determined necessary to supplement, although not required to be part of, the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 19, 2008 on our consideration of Black Hills Educational Benefits Cooperative's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 6 through 9 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*David Pummel & Associates, LLP*

November 19, 2008



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## **REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors  
Black Hills Educational Benefits Cooperative  
Sturgis, South Dakota

We have audited the financial statements of the business-type activities of Black Hills Educational Benefits Cooperative (the Cooperative) (a public entity risk pool) as of and for the fiscal years ended June 30, 2008 and 2007, which collectively comprise the Cooperative's basic financial statements and have issued our report thereon dated November 19, 2008. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States.

### Internal Control over Financial Reporting

In planning and performing our audit, we considered the Cooperative's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Cooperative's ability to initiate, authorize, record, process, or report financial data reliably in accordance



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND  
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (CONTINUED)**

with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Cooperative's financial statements that is more than inconsequential will not be prevented or detected by the Cooperative's internal control. We consider the deficiencies described in the accompanying schedule of findings as item 2008-1 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Cooperative's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings as item 2008-2.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND  
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (CONTINUED)**

The Cooperative's written response to the significant deficiencies identified in our audit has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties. However, as required by South Dakota Codified Law 4-11-11, this report is a matter of public record and its distribution is not limited.

*David Pummel & Associates, LLP*

November 19, 2008



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**MANAGEMENT DISCUSSION AND ANALYSIS**  
**JUNE 30, 2008**

This section of Black Hills Educational Benefits Cooperative's (BHEBC) annual financial report presents discussion and analysis of BHEBC's financial performance during the fiscal year ended on June 30, 2008. Please read it in conjunction with BHEBC's financial statements, which follow this section.

**FINANCIAL HIGHLIGHTS**

- BHEBC's net assets increased \$229,664, while cash decreased; the decrease was more than offset by the increase in investments.
- During the year, BHEBC's revenues generated from premiums and investment income were \$229,664 more than the \$3,571,538 expenditures.
- The total cost of BHEBC's programs increased by 2.4% which was primarily due to an increase in claims.
- The proprietary fund reported a \$229,664 current year surplus due to higher than anticipated investment income, preferred provider organization (PPO) network savings, and stop loss reimbursements.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This annual report consists of two parts - management's discussion and analysis (this section), and the basic financial statements.

Proprietary fund statements offer short and long-term financial information about the activities that BHEBC operate like a business.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

**Fund Financial Statements**

The fund financial statements provide more detailed information about BHEBC's one fund. Funds are accounting devices used to keep track of specific sources of funding and spending for particular purposes. Fund accounting is required by South Dakota State Law.

BHEBC's operations fall under the Proprietary Fund type.

Proprietary Fund - Services for which BHEBC charges a fee are reported in a proprietary fund. The insurance fund is the only fund maintained by BHEBC.



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)  
JUNE 30, 2008**

**FINANCIAL ANALYSIS OF BHEBC AS A WHOLE**

**Net Assets**

BHEBC's combined statement of net assets increased as follows:

**Table A-1  
Black Hills Educational Benefits Cooperative  
Statement of Net Assets**

	<b>Proprietary Fund Activities FY 2008</b>	<b>Proprietary Fund Activities FY 2007</b>	<b>Proprietary Fund Activities FY 2006</b>
Current Assets	<u>\$3,164,733</u>	<u>\$3,054,902</u>	<u>\$2,204,832</u>
<b>Total Assets</b>	<u>\$3,164,733</u>	<u>\$3,054,902</u>	<u>\$2,204,832</u>
Current Liabilities	<u>\$ 204,417</u>	<u>\$ 324,250</u>	<u>\$ 136,213</u>
<b>Total Liabilities</b>	<u>\$ 204,417</u>	<u>\$ 324,250</u>	<u>\$ 136,213</u>
Unrestricted Net Assets	<u>\$2,960,316</u>	<u>\$2,730,652</u>	<u>\$2,068,619</u>
<b>Total Net Assets</b>	<u>\$2,960,316</u>	<u>\$2,730,652</u>	<u>\$2,068,619</u>
Beginning Net Assets	\$2,730,652	\$2,068,619	\$1,518,418
Increase in Net Assets	\$ 229,664	\$ 662,033	\$ 550,201
<b>Percentage of Increase in Net Assets</b>	8.41%	32.00%	36.24%

The Statement of Net Assets reports all financial and capital resources. The statement presents the assets and liabilities in order of relative liquidity. The liabilities of BHEBC, consisting of claims incurred but not paid, have been reported in this same manner on the Statement of Net Assets. The difference between BHEBC's assets and liabilities is its net assets.

**Changes in Net Assets**

BHEBC's revenues totaled \$3,801,202. (See Table A-2.) Most of BHEBC's revenue comes from Other Revenue - Local Sources i.e. premiums from member districts.

BHEBC's expenses cover support services, which include board services and fiscal services; and non-programmed charges, which include insurance premiums, claims, claims services, and claims administration services.

**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)  
JUNE 30, 2008**

**BUSINESS-TYPE ACTIVITIES**

Table A-2 also considers the operations of the business-type activities.

Revenues from BHEBC's business-type activities increased by 2.4% to \$3,801,202, and expenses increased by 17.1% to \$3,571,538. Factors contributing to these changes include:

- Revenues increased because of an increase in investment income, which was offset by a decrease in premiums, COBRA and retiree participation.
- The primary reason for the increase in expenses is a 19.11% increase in the net claims paid and an 11.31% increase in premiums paid.

**Table A-2  
Black Hills Educational Benefits Cooperative  
Changes in Net Assets**

	<b>Total Proprietary Fund Activities FY 2008</b>	<b>Total Proprietary Fund Activities FY 2007</b>	<b>Total Proprietary Fund Activities FY 2006</b>
<b>Revenues</b>			
Earnings from			
Investments & Deposits	\$ 236,441	\$ 129,056	(\$ 31,305)
Other Revenue - Local			
Sources	<u>3,564,761</u>	<u>3,582,924</u>	<u>3,550,216</u>
<b>Total Revenues</b>	<u>3,801,202</u>	<u>3,711,980</u>	<u>3,518,911</u>
<b>Expenses</b>			
Support Services	7,638	6,900	7,428
Non-Programmed Charges	<u>3,563,900</u>	<u>3,043,046</u>	<u>2,961,282</u>
<b>Total Expenses</b>	<u>3,571,538</u>	<u>3,049,946</u>	<u>2,968,710</u>
<b>Increase in Net Assets</b>	<u>229,664</u>	<u>662,034</u>	<u>550,201</u>
<b>Ending Net Assets</b>	<u>\$2,960,316</u>	<u>\$2,730,653</u>	<u>\$2,068,619</u>

**FINANCIAL ANALYSIS OF BHEBC'S FUNDS**

The Proprietary Funds increased \$229,664 this year. The additional resources will be used to offset future premium increases.

**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
MANAGEMENT DISCUSSION AND ANALYSIS (CONCLUDED)  
JUNE 30, 2008**

**BUDGETARY HIGHLIGHTS**

The Board approves a preliminary budget in May and adopts the final budget in August.

**CAPITAL ASSET ADMINISTRATION**

BHEBC has not acquired any capital assets.

**LONG-TERM DEBT**

BHEBC has not and can not incur any long-term debt.

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

BHEBC's current economic position has seen a significant increase in fund balance. This increase allowed for no increase in premiums while the industry increases are in the double digits. The overall budget for next year decreased due to declining participation in the risk pool of BHEBC.

**CONTACTING BHEBC'S FINANCIAL MANAGEMENT**

This financial report is designed to provide citizens, taxpayers, customers, investors and creditors with a general overview of BHEBC's finances and to demonstrate BHEBC's accountability for the money it receives. If you have questions about this report or need additional information, contact Black Hills Special Services Cooperative's Business Office, P.O. Box 218, Sturgis, SD 57785.



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**STATEMENTS OF NET ASSETS**  
**JUNE 30, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
<b>CURRENT ASSETS</b>		
Cash	\$ 106,050	\$ 349,152
Accounts receivable	126,307	12,110
Prepaid insurance	1,384	500
Investments	<u>2,930,992</u>	<u>2,693,140</u>
<b>TOTAL CURRENT ASSETS</b>	<u>\$3,164,733</u>	<u>\$3,054,902</u>
 <b>CURRENT LIABILITIES</b>		
Claims incurred but not reported	<u>\$ 204,417</u>	<u>\$ 324,250</u>
<b>TOTAL CURRENT LIABILITIES</b>	<u>204,417</u>	<u>324,250</u>
 <b>NET ASSETS - UNRESTRICTED</b>	<u>2,960,316</u>	<u>2,730,652</u>
 <b>TOTAL CURRENT LIABILITIES AND NET ASSETS</b>	<u>\$3,164,733</u>	<u>\$3,054,902</u>

See accompanying notes.



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS**  
**FOR THE YEARS ENDED JUNE 30, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
<b>OPERATING REVENUE</b>		
Premiums	\$ 3,564,761	\$ 3,582,924
<b>OPERATING EXPENSE</b>		
Advertising	613	513
Administration	106,016	106,136
Claims	2,904,108	2,438,138
Directors' fees	2,775	3,150
Insurance premiums	553,407	498,212
Professional fees	4,250	3,750
Supplies	369	48
	<u>3,571,538</u>	<u>3,049,947</u>
<b>OPERATING INCOME (LOSS)</b>	( 6,777)	532,977
<b>NONOPERATING REVENUE (EXPENSE)</b>		
Investment income	147,406	113,986
Net realized gain on investments	2,094	49
Net unrealized gain on investments	86,941	15,021
	<u>236,441</u>	<u>129,056</u>
<b>INCREASE IN NET ASSETS</b>	229,664	662,033
<b>NET ASSETS - BEGINNING OF YEAR</b>	<u>2,730,652</u>	<u>2,068,619</u>
<b>NET ASSETS - END OF YEAR</b>	<u>\$ 2,960,316</u>	<u>\$ 2,730,652</u>

See accompanying notes.



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED JUNE 30, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash receipts from participants	\$3,564,761	\$3,582,924
Claims paid	( 3,138,138)	( 2,231,927)
Cash payments for insurance	( 554,291)	( 456,303)
Cash payments for administration	( 106,016)	( 106,136)
Other operating cash payments	( 8,007)	( 7,461)
<b>NET CASH PROVIDED BY (USED IN)</b> <b>OPERATING ACTIVITIES</b>	( 241,691)	781,097
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sale of investments	240,373	149,794
Purchase of investments	( 389,190)	( 1,061,495)
Investment income	147,406	113,986
<b>NET CASH USED IN</b> <b>INVESTING ACTIVITIES</b>	( 1,411)	( 797,715)
<b>NET INCREASE (DECREASE) IN CASH</b>	( 243,102)	( 16,618)
<b>CASH - BEGINNING OF YEAR</b>	349,152	365,770
<b>CASH - END OF YEAR</b>	<u>\$ 106,050</u>	<u>\$ 349,152</u>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO</b> <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Operating income (loss)	(\$ 6,777)	\$ 532,977
Adjustments to reconcile operating income to net cash provided by operating activities		
Decrease (increase) in		
Accounts receivable	( 114,197)	18,174
Prepaid insurance	( 884)	41,909
Increase (decrease) in		
Claims payable	( 119,833)	188,037
<b>NET CASH PROVIDED BY (USED IN)</b> <b>OPERATING ACTIVITIES</b>	( \$ 241,691)	\$ 781,097

See accompanying notes.



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2008 AND 2007**

**NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Description of the Cooperative

The Black Hills Educational Benefits Cooperative (the Cooperative) is a public entity risk pool organized as a cooperative education service unit, comprised of member public entities. The Cooperative was organized July 1, 1996 to provide employee health benefit services to employees of member public entities through a partially self-funded plan. Risk is assumed by Black Hills Educational Benefits Cooperative. Member public entities are not liable for claims in excess of Cooperative assets. The goal of the Cooperative is to assist participating member public entities in providing appropriate benefits for all employees and families on a cooperative basis, services that these public entities would not be able to provide as effectively or as economically acting alone. Public entities seeking membership must be approved by an affirmative vote of a majority of the members of the Board of Directors. Any member entity may withdraw from the Cooperative by action of its Board of Directors. Withdrawal notice shall be made prior to February 1 for the succeeding school year. The Board of Directors can raise premiums or commit participating entities to obligations beyond the membership period. The Cooperative cannot enter into any long-term debt. A third party administrator is selected to administer all claims and secure reinsurance and other insurance coverage. Plan members currently are Black Hills Special Services Cooperative, New Underwood School District 51-3, Wall School District 51-5, Custer School District 16-1, Oelrichs School District 23-3, and Belle Fourche School District 9-1.

Summary of Significant Accounting Policies

1. Basis of Accounting

The Cooperative is a government entity comprised of one enterprise fund which uses the accrual basis of accounting for financial statement purposes. Revenues are recognized in the period in which they become due. Expenses are recognized in the period in which the related liability is incurred. The enterprise fund, which is a proprietary fund type, does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989.

**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2008 AND 2007**

**NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Summary of Significant Accounting Policies (Continued)

2. Deposits and Investments - Credit Risk, Concentrations of Credit Risk and Interest Rate Risk

Various restrictions on deposits and investments are imposed by statutes. These restrictions are summarized below:

Deposits - The Cooperative deposits are made in qualified public depositories as defined by SDCL 4-6A-1, 13-16-15, 13-16-15.1 and 13-16-18.1. Qualified depositories are required by SDCL 4-6A-3 to maintain at all times, segregated from their other assets, eligible collateral having a value equal to at least 100 percent of the public deposit accounts which exceed deposit insurance such as the FDIC and NCUA. In lieu of pledging eligible securities, a qualified public depository may furnish irrevocable standby letters of credit issued by federal home loan banks accompanied by written evidence of that bank's public debt rating which may not be less than "AA" or a qualified public depository may furnish a corporate surety bond of a corporation authorized to do business in South Dakota.

Investments - In general, SDCL 4-5-6 permits Cooperative funds to be invested in (a) securities of the United States and securities guaranteed by the United States government either directly or indirectly; or (b) repurchase agreements fully collateralized by securities described in (a) above; or in shares of an open-end, no-load mutual fund administered by an investment company whose investments are in securities described in (a) above; and repurchase agreements described in (b) above. Also, SDCL 4-5-9 requires investments to be in the physical custody of the political subdivision or may be deposited in a safekeeping account with any bank or trust company designated by the political subdivision as its fiscal agent.



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2008 AND 2007**

**NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Summary of Significant Accounting Policies (Continued)

2. Deposits and Investments (continued)

Credit Risk - State law limits eligible investments for the Cooperative, as discussed above. The Cooperative has no investment policy that would further limit its investment choices.

The Cooperative had the following investments at June 30, 2008 and 2007. All investments are in an internal deposit and investment pool.

	<u>Credit Rating</u>	<u>2008 Market Value</u>	<u>2007 Market Value</u>
Government National Mortgage Assn Real Estate Mortgage Investment Conduits	Not Rated	\$ 41,743	\$ 40,872
Federal National Mortgage Assn Notes	AAA	133,007	104,214
Real Estate Mortgage Investment Conduits	Not Rated	474,023	482,299
Federal Home Loan Mortgage Corp Notes	AAA	299,835	244,872
Real Estate Mortgage Investment Conduits	Not Rated	1,243,242	1,256,840
Tennessee Valley Authority Notes	AAA	<u>78,143</u>	<u>76,372</u>
Total Investments		<u>\$2,269,993</u>	<u>\$2,205,469</u>

As of June 30, 2008, the Coop had the following maturities of investments:

	<u>Fair Value</u>	<u>Investment Maturities (in years) 5-10</u>	<u>More Than 10</u>
Government National Mortgage Assn Real Estate Mortgage Investment Conduits	\$ 41,743	\$	\$ 41,743
Federal National Mortgage Assn Notes	133,007		133,007
Real Estate Mortgage Investment Conduits	474,023		474,023
Federal Home Loan Mortgage Corp Notes	299,835	100,752	199,083
Real Estate Mortgage Investment Conduits	1,243,242		1,243,242
Tennessee Valley Authority Notes	<u>78,143</u>		<u>78,143</u>
	<u>\$2,269,993</u>	<u>\$ 100,752</u>	<u>\$2,169,241</u>



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2008 AND 2007**

**NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The Real Estate Mortgage Investment Conduits are categorized based on their due date. Many of the REMICs pay principal throughout their life.

The Real Estate Mortgage Investment Conduits (REMICs) above do not qualify as lawful investments under state law.

Interest Rate Risk - The Cooperative does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Concentration of Credit Risk - The Cooperative places no limit on the amount that may be invested in any one issuer.

Custodial Credit Risk - The Cooperative's investments are held by RBC Dain Rauscher which has been designated its fiscal agent. There is no investment policy limiting the amount that can be held by one fiscal agent.

**3. Cooperative Benefits**

Cooperative liabilities for health claims incurred but not reported are estimated by the third party administrator based on experience and claims filed after the Cooperative's year-end.

**4. Cash Flows**

For the purpose of the Statement of Cash Flows, the Cooperative considers all highly liquid investments and deposits with a term to maturity of three months or less when purchased to be cash equivalents.

**5. Estimates**

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**JUNE 30, 2008 AND 2007**

**NOTE 1 - DESCRIPTION OF THE COOPERATIVE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONCLUDED)**

**6. Revenue and Expense Classifications**

In the proprietary fund's Statements of Revenue, Expenses and Changes in Net Assets, revenues and expenses are classified in a manner consistent with how they are classified in the Statements of Cash Flows. That is, transactions for which related cash flows are reported as capital and related financing activities, noncapital financing activities, or investing activities are not reported as components of operating revenues or expenses.

**7. Equity Classifications**

Equity is classified as net assets. The Cooperative has only unrestricted net assets. Unrestricted net assets are defined as all net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

**NOTE 2 - UNPAID CLAIMS LIABILITIES**

As discussed in Note 1, the Cooperative establishes a liability for both reported and unreported insured events, which includes estimates of future payments and losses. The following represents changes in those aggregate liabilities for the Cooperative during the years ended June 30, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Amounts currently payable and estimated incurred but not reported to or for participants and dependents		
Balance at beginning of year	\$ 324,250	\$ 136,213
Claims reported and approved for payment	3,346,692	2,275,980
Claims paid	( 3,346,692)	( 2,275,980)
Increase (decrease) in estimated claims incurred but not reported	( 119,833)	188,037
Balance at end of year	<u>\$ 204,417</u>	<u>\$ 324,250</u>

**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE**  
**NOTES TO FINANCIAL STATEMENTS (CONCLUDED)**  
**JUNE 30, 2008 AND 2007**

**NOTE 3 - RELATED PARTY**

Black Hills Special Services Cooperative (BHSSC) provides office space, office supplies, and wages for the program administrator for the Cooperative. The Cooperative reimburses BHSSC \$300 per month for these expenses.

**NOTE 4 - EXCESS RISK HEALTH INSURANCE AND LIFE INSURANCE**

The Cooperative purchases excess risk insurance covering claims over \$70,000 per policy year per covered person. The policy has a maximum aggregate benefit of \$1,000,000 per policy year. The Cooperative also purchases life insurance for plan participants.

**NOTE 5 - ELIGIBLE INVESTMENTS**

The Cooperative has invested in Real Estate Mortgage Investment Conduits (REMICs) which, because they are derivatives of the underlying securities, do not qualify as lawful investments under SDCL 4-5-6.

The Cooperative has ceased investing in REMICs but did not sell the existing portfolio REMICs as a significant financial loss was anticipated if the securities were sold prior to maturity.

**NOTE 6 - RISK MANAGEMENT**

The Cooperative is exposed to various risks of loss related to torts and errors and omissions. During the period ended June 30, 2008, the Cooperative managed its risks as follows:

Liability Insurance

The Cooperative purchases liability insurance for risks related to torts and errors and omissions of directors and officers from a commercial carrier.

**NOTE 7 - SUBSEQUENT EVENTS**

For the period July 1, 2008 to October 31, 2008 the Cooperative's investments had accumulated unrealized losses of \$129,856.

**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
SCHEDULE OF AUDIT FINDINGS  
JUNE 30, 2008**

**PRIOR AUDIT FINDINGS**

**Finding 2007-1 Segregation of Duties**

This finding has been restated as current audit finding 2008-1.

**Finding 2007-2 Qualified Investments**

This finding has been restated as current audit finding 2008-2.

**CURRENT AUDIT FINDINGS**

**Finding 2008-1 Segregation of Duties**

**Criteria**

A good system of internal accounting control includes the segregation of duties of accounting personnel, where no one individual has control over the assets, records transactions, and authorizes transactions.

**Condition**

Black Hills Educational Benefits Cooperative (BHEBC) does not have an adequate segregation of duties over the general operating and investment accounts.

**Cause**

The size of the BHEBC staff does not provide for an optimum segregation of duties, although several compensating monitoring controls have been implemented.

**Effect**

One employee has control of the assets, records transactions and authorizes transactions.

**Recommendation**

Many compensating monitoring activities have been implemented using the board of directors and other Black Hills Special Services Cooperative employees. The board of directors and manager should continue to implement and perform all practical oversight and review functions.

**Management's Response**

BHEBC does not employ any staff. BHEBC contracts with Black Hills Special Services Cooperative (BHSSC) for fiscal services. Because of the limited number of banking, investment, and general ledger transactions during the year, the fiscal services are provided primarily by one staff person, with compensating monitoring activities by the board of directors, the independent claims administrator and other BHSSC staff. All premiums received are monitored by the independent claims administrator, First Administrators, and all individual claims paid are reviewed, approved and paid by First Administrators. Due to its size, it is not cost beneficial to take further corrective action.



**BLACK HILLS EDUCATIONAL BENEFITS COOPERATIVE  
SCHEDULE OF AUDIT FINDINGS (CONTINUED)  
JUNE 30, 2008**

**CURRENT AUDIT FINDINGS (CONTINUED)**

**Finding 2008-2 Qualified Investments**

**Criteria**

The Cooperative is required to follow SDCL 4-5-6 requirements for investments.

**Condition**

Investments in Real Estate Mortgage Conduits (REMICs) of the Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA) do not qualify as lawful investments under SDCL 4-5-6.

**Cause**

The BHEBC and its fiscal agent RBC Wealth Management, were unaware that the REMICs were not lawful investments under South Dakota law.

**Effect**

The Cooperative is invested in unlawful investments.

**Recommendation**

The Cooperative should cease its investment in REMICs and take all prudent steps to dispose of existing REMICs in its portfolio.

**Management's Response**

BHEBC has instructed RBC Wealth Management to discontinue investing in these securities. However, selling the existing securities would result in a significant financial loss to BHEBC. As these securities mature or are called, the monies collected will be reinvested in qualified investments under SDCL 4-5-6.